



Lithuanian Free Market Institute



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The Lithuanian Free Market Institute: A position on employment regulations and the Lisbon strategy

The progress of the Lisbon strategy has suffered serious difficulties. Conflicting goals, ambitious plans and a wish to preserve fairly inert social structures have caused tension in implementing the strategy. The so-called European social model, and employment regulation as an integral part of this model, is one of the most perplexing aspects.

The Lithuanian Free Market Institute (LFMI) has made an analysis of the European Union's Lisbon agenda and its implications for Lithuania (2003)¹ and an analysis of employment regulation (2004).² This paper presents LFMI's opinion on the following issues and related topical questions:

- Problems and implications of employment regulation;
- Labour relationships in Lithuania. How is Lithuania fulfilling its obligations concerning labour relationships?
- Can the implementation of the Lisbon strategy facilitate the improvement of labour relationships? Is there a threat that conflicting goals will jeopardise necessary labour market reforms?
- The position of the Lithuanian government on European law-making procedures: clarity, transparency, openness and involvement of the civil society.
- The Working Time Directive: A solution for employers and workers in Lithuania and the EU?

Problems and implications of employment regulation

Employment regulations provoke heated discussions given that labour relationships between the employer and the worker are not considered to be a proper contract by which two persons agree to freely enter into mutually beneficial cooperation. The majority of people who sell their labour are tied by legal labour relationships.

Employment regulations are initiated on the assumptions that the employer and the worker do not have equal positions in employment negotiations, that the employer invariably holds stronger positions, and that additional legislative safeguards are needed to protect worker rights. A variety of restrictions are placed on employment contracts with a view to protecting the interests of workers. They include a restriction of working time and a minimum wage. Professional unions are granted disproportionately more rights in employment negotiations than employers. Other similar measures are undertaken to ostensibly give employees protection and to restore a balance in negotiations between businesses and workers. These measures make it difficult for employers and workers to

¹ Lithuanian Free Market Institute. Europos Sąjungos Lisabonos darbotvarkės ir jos poveikio Lietuvai įvertinimas. Ekonominės ir socialinės politikos sričių integracijos poveikio analizė. Vilnius 2003. www.lrinka.lt

² Lithuanian Free Market Institute. Darbo santykių ekonominė įtaka ir reformos gairės. Vilnius 2004. www.lrinka.lt

agree on the terms of labour contracts, reduce the dynamism of the labour market and undermine the competitiveness of the country in general and businesses in particular.

Launching employment regulations requires making allowance for the following circumstances.

First of all, freedom of contract, the principle which alongside other aspects means that each party is free to enter into an agreement or not, is valid for labour relationships just like for any other act of exchange. If a contract is signed, it is presumed that the parties to the contract have freely concluded it. If an agreement is made, it means that both parties expect to benefit from it and they value the benefit arising from the agreement more than non-agreement.

Second, businesses and workers are interdependent. This interdependence manifests itself through changes in wages and jobs. The more specific and valuable job a certain worker performs, the more important this worker is, so the company will do its best to attract and retain him or her.

Third, if compulsory terms of employment contract (maximum working time or vacation and the like) as required by law were non-existent, employers and workers would have more opportunity to gain maximum benefits from their labour relationships. For example, the size of the wage is the main condition that is negotiated during the recruitment process because other essential terms of agreement are set out by law. So a worker who is seeking a higher wage cannot offer longer hours or a shorter vacation.

Fourth, the role of professional unions in employment regulation should be reconsidered. At present the law grants professional unions unjustified privileges in negotiating with employers. As was mentioned, this aggravates the position of workers. By law, if there is a professional union and a collective agreement in a company, workers who do not belong to the professional union are banned from signing individual contracts. The law does not provide for the existence of several professional unions that would compete in protecting the interests of their members. Privileges are granted for the members of elected bodies of professional unions: it is more difficult to dismiss elected members and they have concessions concerning paid days off and trainings. There is no doubt that worker organization and group negotiations provide ways to strengthen negotiation positions of workers and an opportunity to obtain more favourable conditions. Most importantly, however, such worker organizations should not be granted in advance any privileges in negotiations or in the terms of contract.

Fifth, it is important to change attitudes towards employment regulations. Both theory and practice show that, even if in some cases employment regulation can benefit workers, in the long run it does harm to businesses, workers and the country's economy and competitiveness alike. Employment regulations should be analysed in terms of their expediency and proportionality. It is also essential to assess their implications and costs for private agents, not only for the state budget.

It is instructive to provide practical examples that support the abovementioned theoretical arguments. The World Bank's study *Doing business in 2005: Removing obstacles to growth*³ ranks employment regulation among overriding factors of a country's competitiveness. The World Bank has compiled an index of labour market flexibility based on the data about hiring and firing conditions, lay-off benefits, notice periods, opportunities to conclude time contracts, regulation of the form of employment contracts, etc. Researchers have come to an explicit conclusion that the more complicated employment regulation is, the more obstacles it poses to economic growth.

³ *Doing business in 2005: Removing obstacles to growth*. Copublication of the World Bank, International Finance Corporation and Oxford University Press. 2004

Labour relationships in Lithuania. How is Lithuania fulfilling its obligations concerning labour relationships?

Research conducted by LFMI⁴ shows that employment regulation attracts a great deal of attention. Labour relationships are subject to detailed and complex regulation which prevents employers and workers from reaching agreement.

- Lithuania has chosen a complicated system of working time regulation. The Lithuanian system is more rigid than that defined in the EU Working Time Directive. A maximum duration of a workday and weekly hours is set and overtime is prohibited. Such a direct and complicated regulation of economic activity does not only undermine business competitiveness but also prevents companies from creating jobs and hiring people.
- Making it a requirement for labour contracts to be in writing is not in the interests of employers or workers. Formalities related to the conclusion of labour contracts raise the cost of labour and postpone the result - the emergence of labour relationships - that both the worker and the employer expect.
- Concluding time contracts for a longer period than five years is prohibited in Lithuania. This prohibition is closely related to the obligation to pay lay-off benefits. Upon the expiry of a time labour contract a worker is not entitled to a layoff benefit. Employers are therefore interested in concluding time contracts. Although in some cases this policy can prevent the termination of employment, it presents a drag on the development of the labour market.
- A mandatory minimum wage is set by law in the name of securing a minimum level of worker income. In reality, however, it is an instrument to boost budget revenues. Regulation of the minimum monthly wage artificially raises the price of labour and leads employers to compensate the increased costs by curbing growth, cutting down the staff and similar measures.
- An employer survey carried out by LFMI shows that the special protection of workers that employment regulation is designed to provide fails to help defend their interests.⁵ As employers note, protection of people of pre-retirement age, pregnant women, the under-aged or the disabled by which the state grants various concessions for companies that hire persons in question bring about undesired results. Concessions get to be abused, while people from the protected groups find it more difficult to get jobs or are ousted from the labour market because of the higher costs they inflict on the employers. So any special government protection increases the costs of hiring and reduces employment opportunities for protected groups.

Easy fire, easy hire is an essential condition of a dynamic labour market. This provision makes it easier to find the best job and the best worker. It enables businesses to adapt to change and to promptly create jobs for they know they will be able to forego these new jobs if business conditions change. The current legislation precludes this sort of flexibility, even though flexibility is in the interests of both employers and workers.

The approximation of Lithuanian law with EU requirements was largely seen as the adoption of stricter regulations and obligations. Yet, analysis of employment regulation in Lithuania and EU directives concerning the labour market shows that Lithuania has consistently applied more rigid rules than those prescribed in EU directives.

⁴ Lithuanian Free Market Institute. Darbo santykių ekonominė įtaka ir reformos gairės. Vilnius 2004. www.lrinka.lt

⁵ Lithuanian Free Market Institute. Darbo santykių ekonominė įtaka ir reformos gairės. Vilnius 2004. www.lrinka.lt

Overtime regulation set out in Lithuanian laws is entirely different from that in the EU. The EU directive places only one restriction on overtime that member states have to comply with. Member states are required to secure that the average working time does not exceed 48 hours per week. A ban on overtime is the main principle on which the Lithuanian overtime regulation is based. Longer hours are allowed only in exceptional cases as defined by law. They refer in essence only to extraordinary situations that economic agents can be faced with.

The Lithuanian labour code prohibits the conclusion of time contracts, except when jobs have a non-permanent nature and in individual cases agreed by collective agreements or indicated in laws. Such a prohibition is not envisaged in EU Directive 1999/70/EB.

The Lithuanian labour code requires that worker representatives are consulted regarding the termination of labour contracts for economic or technological reasons or because of structural changes in the workplace. The Lithuanian provision is broader than that envisaged in EU Directive 98/59/EB.

Can the implementation of the Lisbon strategy facilitate the improvement of labour relationships? Is there a threat that conflicting goals will jeopardise necessary labour market reforms?

The major objective of the Lisbon strategy, adopted at the Lisbon summit in 2000, is reflected in the formulation that within a decade the European Union is expected to become “the most competitive and dynamic knowledge-based economy in the world capable of sustainable economic growth with more and better jobs and greater social cohesion.”⁶ To deliver this goal, two main lines of action are set: (i) preparing the transition to a competitive and dynamic knowledge-based economy and (ii) modernising and strengthening the European social model by investing in people and building the welfare state. The tasks arising from the latter objective have the biggest implications for employment regulation: strengthening of the European social model, boosting employment and achieving greater entrepreneurship and investment into human resources through education and training.

The main inner conflict of the Lisbon strategy stems from the objective of more and better jobs and greater entrepreneurship to be achieved by improving business conditions and lifting the burden of employment regulation and at the same time by preserving and enhancing social protection. In the concept of the European social model „social cohesion is defined as an objective which does not contradict but supplements the economic goals of the European Union, such as more and better jobs, higher productivity, competitiveness and economic growth.”⁷ The Lisbon strategy and subsequent documents regard economic growth as a vehicle not for creating well-being but for modernising and maintaining the European social model.

A 2004 report providing an assessment of the Lisbon goals⁸ concludes that „overloaded agendas, poor coordination and conflicting priorities“ have upset the accomplishment of these goals, but the

⁶ The Lisbon European Council – An agenda of Economic and Social renewal for Europe. Contribution of the European Commission to the Special European Council in Lisbon, 23-24th March 2000.

⁷ Lietuvos laisvosios rinkos institutas. Europos Sąjungos Lisabonos darbotvarkės ir jos poveikio Lietuvai įvertinimas. Ekonominės ir socialinės politikos sričių integracijos poveikio analizė. Vilnius 2003. www.lrinka.lt

⁸ Facing the challenge. The Lisbon strategy for growth and employment. Report from the High level group chaired by Wim Kok. November 2004.

main problem is with „a lack of determined political action.“⁹ Although the report stresses that raising economic growth and employment are the primary tasks to achieve the Lisbon goals, policies are being pushed into an open, albeit obvious, trap. On the one hand, the report admits the importance of „allowing businesses and workers the flexibility to provide, and seize, opportunities“ and „securing labour market flexibility, balanced by appropriate levels of security“, i.e. reducing employment regulation, accommodating the accomplishment of *easy fire, easy hire* and so creating more flexible and dynamic relationships between businesses and workers. On the other hand, this does not mean, the report notes, weakening worker rights and protection.¹⁰

EU member states and politicians are being sent erroneous signals. For one thing, the implementation of the measures designed to create flexible and dynamic relationships between employers and workers cannot aggravate the situation of all workers as flexibility allows companies to create more and better jobs.¹¹ Second, formulations that embody political compromises and correctness at the EU level are used as arguments by confronting sides in the law-making process in member states: everybody is right saying that they draw on EU policy.

In addition to that, it is important to look into the measures that the Lisbon strategy and subsequent documents prescribe for promoting greater investment into human capital and employment of the elderly, women and other protected groups. It is stressed that investing in people is an important factor of the EU economy, while elderly employment may help tackle the problems of competitiveness and defective social security systems. However, the subject, or who is supposed to invest in human capital, is not defined. It is usually businesses and individuals themselves who do that, therefore member states have limited possibilities to influence these processes. Private motives are the most effective stimuli of investment into R&D and human capital. Granting tax incentives or placing legal duties on employers with a view to delivering these goals finally lead to abuse and the ousting of the protected groups from the labour market. It should be noted that the Lisbon objective concerning female employment is not relevant for Lithuania where male unemployment is higher than female unemployment.¹²

LFMI believes that implementing the Lisbon goals requires making allowance for the following circumstances.

First of all, it should be admitted that the Lisbon goals are contradictory and pose obstacles to their implementation.

Second, the Lisbon strategy is a political document embodying compromises which, unfortunately, cannot provide a consistent agenda for accomplishing the goal of a more competitive Europe in the world.

Third, it is recognized that greater entrepreneurship and more and better jobs are measures tailored to strengthen social cohesion. It is admitted that creating better opportunities for people to earn has a profound influence on the labour market, a country's economy and competitiveness, and people's psychological and social well-being. For these reasons the framework of the Lisbon strategy should retain greater social protection as one of its objectives. However, it is essential to forego special

⁹ Ibid. P. 6. „overloaded agenda, poor coordination and conflicting priorities“ „lack of determined political action“.

¹⁰ Ibid. P. 31.

¹¹ See above: **Darbo santykių reguliavimo problemos ir pasekmės.**

¹² Socialinės apsaugos ir darbo ministerija. Socialinis pranešimas 2003. p.13

government policies concerning employment regulation and to focus on creating a flexible and dynamic labour market instead.

The Lisbon objectives are defined in the framework of the European social model. Employment regulation is an integral part of this model. In terms of social policy and employment regulation the EU is pursuing the objectives laid down in the Treaty establishing the European Communities: the promotion of employment, improved living and working conditions, so as to make possible their harmonisation while the improvement is being maintained, proper social protection, dialogue between management and labour, the development of human resources with a view to lasting high employment and the combating of exclusion.¹³ With a view to achieving these objectives the EU adopts directives and minimum requirements¹⁴ or encourages cooperation between the member states and facilitates the coordination of their action.¹⁵ Drawing on its prerogative to secure a free movement of labour, the EU has consistently expanded employment regulation. It can be observed that since the inception of the European Union employment regulation has increasingly become social safety-oriented.¹⁶ So the area in which the EU acts by adopting directives and setting minimum requirements has been widening.

Member states are allowed to adopt final rules concerning specific labour market regulation. However, they are framed within the requirements laid down in EU law. It is therefore important to distinguish between the objectives which the EU pursues by promoting labour relationships and the key principles and measures that are designed to achieve these objectives. The general objectives as set out in Article 136 of the founding Treaty do not cause much discussion, but employment regulation measures deserve a more critical assessment:

- Protection of worker interests. As was mentioned,¹⁷ the employer is not *de facto* a stronger party in labour contract negotiations, for if two parties reach an agreement, it means mutual benefit and inter-dependence. Therefore this unjustified and one-sided defence of workers does harm to the overall well-being of employers and workers.
- Promotion of collective labour relationships on the assumption that they can help to better advance worker interests. Even if collective relationships provide workers advantages in negotiations with employers, they have serious flaws in reconciling diverse interests of workers. Collective relationships have been discredited by the operation of privileged professional unions.
- Special measures designed to protect the rights of special groups – women, the disabled and the elderly – in labour relationships. As was mentioned, a special protection on the part of the state increases the costs of hiring persons from the protected groups so that it directly reduces labour market opportunities for such individuals.
- The principle of subsidiarity should be applied in assessing employment regulation adopted in the member states, just as it is followed in dividing competence between the EU and member states but also. It is important that not only the member states but also employers and workers get together and address labour market issues. This would accommodate the implementation of the principle of subsidiarity and enable the adoption of specific decisions at a lower level.

¹³ EC Founding Treaty, Article 136.

¹⁴ EC Founding Treaty, Article 137.

¹⁵ EC Founding Treaty, Article 140.

¹⁶ T. Davulis. Darbo teisė: Europos Sąjunga ir Lietuva. Vilnius, Teisinės informacijos centras, 2004. p. 35-47

¹⁷ See above: Problems and implications of employment regulation.

Europe's competitive disadvantages resulting from complicated employment regulation are criticised in various investor surveys.

According to *Ernst & Young's „European attractiveness survey 2004“*,¹⁸ the heads of business companies polled report that investors value Europe for its good workforce, transparency, political, legal and other types of stability, good geographical location and infrastructure. The main weaknesses of the European investment climate related to the work force, the survey notes, are expensive labour force, relatively low productivity and rigid employment regulation.

Other surveys indicate that restrictive employment regulation is considered to be a serious drag on investment. Only high corporate taxes and corruption are listed as bigger investment barriers.¹⁹

There are examples of effective solutions and sound changes that the member states adopt with a view to advancing dynamic labour relationships and achieving established social policy objectives.

In September 2003 Italy enforced amendments to employment regulation and simplified hiring and firing procedures. In addition to that, requirements placed on employment agencies were eased so that universities, schools, local administrations and other institutions were allowed to act as employment agencies.²⁰

In 2002 Denmark enforced legislative amendments allowing workers to opt out from the collective agreements that embraced them and to make individual agreements with the employer concerning shorter hours. The Danish government admitted that collective agreements had failed to reconcile the interests of workers and that individual agreements would provide better protection for those who chose to work shorter hours because of childcare or eldercare.²¹

The position of the Lithuanian government on EU law-making procedures: clarity, transparency, openness and involvement of the civil society.

Lithuania's full participation in the EU law-making process presents a new opportunity for Lithuania and new challenges for the national government and legislature. The Lithuanian government has to advance the EU objective of making the legislative process and the managing of EU affairs more open and transparent and of involving the civil society in these processes on a wider scale. People in Lithuania took an active part in the elections to the European Parliament. The elected parliamentarians have undertaken political obligations that require them to explain to the public the implications of the ongoing processes in the EU for Lithuania and to demonstrate their position and work. The elections to the European Parliament and the information campaign enhanced markedly public awareness of the powers and work of the European Parliament and the issues addressed in the EU, even though the electoral debates in Lithuania, just like in many other states, focused on domestic issues. Similarly, it was constantly stressed that the thirteen Lithuanian parliamentarians would have a limited influence on issues addressed in the EU. There is a lack of public awareness and knowledge of the way in which the national government participates in the

¹⁸ Ernst&Young. Europe: The opportunity of diversity. International executives assess Europe. 2004. Internet: [http://www.ey.com/global/download.nsf/Lithuania_E/European_Attractiveness_Survey_2004/\\$file/European%20Attractiveness%20Survey%202004.pdf](http://www.ey.com/global/download.nsf/Lithuania_E/European_Attractiveness_Survey_2004/$file/European%20Attractiveness%20Survey%202004.pdf) Prisijungta: 2005 sausio 10d.

¹⁹ *Doing business in 2005: Removing obstacles to growth*. Copublication of the World Bank, International Finance Corporation and Oxford University Press. 2004 p. 31

²⁰ International Reform Monitor. Social Policy. Labor Market Policy. Industrial Relations. Issue 9. 2004. Bertelsmann Stiftung.

²¹ International Reform Monitor. Social Policy. Labor Market Policy. Industrial Relations. Issue 7. 2003. Bertelsmann Stiftung.

European Council, where it exercises much wider powers, and in the EU law-making process. This suggests that the national authorities should become more open and involve the society in these processes.

National opinions in the decision-making of the European Council, which has the biggest weight on the legislative process in the EU, are expressed through a national position on a given legislative proposal. The European Council adopts decisions in accordance with the rules laid down in the Founding Treaty of the European Communities. The position of each member-state is of great importance. EU law has a profound impact on the life of Lithuanian people and the operation of Lithuanian companies, therefore openness, transparency and involvement of civil society is key to promoting democratic decision making.

The Lithuanian government is the principal author of the Lithuanian position in accordance with Government Decree of January 2004.²² Lithuanian positions are formulated by responsible ministries or inter-agency task forces. The practice of recent years shows that the national government lacks openness. Important legislative proposals from the government are frequently inaccessible to the public. Journalists and reporters have been denied access to governmental sittings, etc. The Lithuanian government should make an effort to ensure that the new and uneasy task of defining Lithuanian positions is carried out openly, transparently and cooperatively, as is the objective of EU institutions and other member states.

LFMI is of the opinion that the process of drafting the Lithuanian position requires:

- publicising information about who is responsible for adopting a decision concerning a given national position;
- publicising such decisions and national positions;
- creating mechanisms for participation of civil society groups in formulating national positions: publicising the procedures of drafting legislative proposals and presenting opinion to the public and persons responsible for adopting decisions on national positions;
- in accordance with the requirement of confidentiality of negotiation documents and on the ground that tentative positions are not publicised, ensuring that draft proposals from the EU are not concealed from the public. It is important to follow the rule that confidential documents are those which present a state secret or whose confidentiality is otherwise protected by law. All other documents should be accessible to the public.

The Working Time Directive: A solution for employers and workers in Lithuania and the EU?

A revision of Directive 2003/88 on certain aspects of organization of working time as proposed by the Commission contains several major changes concerning a possibility to opt out from the 48-hour rule, extension of the reference period from four to twelve months and the concept of *on-call time*.

LFMI believes that workers should be enabled to scrap the 48-hour rule in their labour contracts. First of all, it is important to allow workers to freely decide on all terms of their labour contracts. Second, legislative restrictions and collective agreements fail to reconcile diverse interests and needs of workers, therefore creating a possibility to make individual arrangements and agreements

²² LR Vyriausybės nutarimas Dėl Lietuvos Respublikos pozicijos Europos Sąjungos institucijose nagrinėjama klausimais rengimo, derinimo, pristatymo ir Europos Sąjungos teisės (*acquis communautaire*) perkėlimo į Lietuvos Respublikos nacionalinę teisę ir jos įgyvendinimo (2004 m. sausio 9 d. Nr. 21, 2004 rugsėjo 19 d. redakcija).

is crucial. Making it possible to opt out from the 48-hour rule would allow persons who choose longer hours and those who want to work shorter hours to realize their interests. Third, the rule in question is safeguarded by proven data that longer hours make workers get more tired. These conclusions are accessible to the public. Both research and personal experience make workers aware of them. This enables workers to make informed decisions regarding the duration of their weekly hours. Fourth, more flexibility in applying the 48-hour rule would help achieve the Lisbon goal of more and better jobs. These conditions would advance the development of „a flexible and adaptable labour market.”

It is the opinion of LFMI that the extension of the reference period would provide more opportunity to absorb and adapt to labour market changes.